IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1969

No. 1702

ILO VANDERBOOM, DeHAAN LIVESTOCK & GRAIN FARMS, INC., ANDY D. DeHAAN, KENNETH J. DeHAAN, LYLE R. DeHAAN, H. T. RINGLING, JAMES NACHTIGAL, ROBERT CARTER, R. S. MISKIMINS, RICHARD ADAMSON, WENDELL FOXLEY, JAMES KLAUDT, DONALD O. NACHTIGAL, WILLIAM NASH, ERVIN R. ORTMAN, HERBERT W. ORTMAN, STANLEY W. WEILAND, and INVESTORS THRIFT CORPORATION, an Arkansas Corporation,
Petitioners,

vs.

SAM SEXTON, JR., JAMES S. HALL, AUSTIN GATLIN, DIAMOND G RANCH, INC., an Arkansas Corporation, TEXAS CAPITAL CORPORATION, a Texas Small Business Investment Company,
Respondents.

REPLY BRIEF OF PETITIONERS

REASONS FOR GRANTING THE WRIT

1. Class Protected and Class Obligated—Privity Requirement of 10 b-5 cases.

The respondents take issue with the petitioners' characterization of the facts because they fear a lucid examination of the factual contents of the package presented here.

The facts outlined in the petition for writ are taken from the record and the opinions of the Courts below. The facts as presented lift the fog of confusion which all parties have permitted to exist in this case in the Courts below through false labeling, and by emphasis upon labels rather than the factual content of the case presented. It is the clarity of the presentation by appropriate characterization of the facts that frightens the respondents.

If an analysis of the facts on summary judgment reveals that the only securities transaction involved in the case is the purchase of corporate securities by ITC from Hall, Sexton, Smith and Telcom Corporation, then the Courts below are correct in holding that only ITC has standing to sue. Under such circumstance, we are left with the most important issue of the appropriate characterization of a Rule 10 b-5 action.

But clearly, ITC is not the sole securities purchaser before this Court. The individual investors also purchased through an instrumentality of interstate commerce corporate securities from ITC, the issuer, on the basis of fraudulent representations, fraudulent concealments, and on the basis of a concerted scheme of the respondents to commit a classic fraud by "dumping" their worthless assets on ITC. Such a result was possible only if the individuals were first fraudulently convinced that ITC was acquiring valuable assets. No court has required the purchaser and the seller to be opposing parties for "standing to sue" where the fraud was committed by a third party.[1]

Are the co-schemers to escape responsibility for their fraudulent acts because of the existence, perhaps, of a technical defect in the action of ITC?

---

[1] See **Rekant v. Desser**, 425 F. 2d 872 (5th Cir. April 20, 1970), holding that a corporate issuer is a seller of securities.

The investors bought ITC stock in direct and natural reliance upon respondents' representations of the net worth, value, profitability and loan capacity of the corporate assets being purchased by ITC, to-wit: AHB and PL&I. In fact, ITC purchased all of the issued common stock of American Home Builders Supply Company, which in turn owned all the stock of American Home Builders, Inc. (called AHB), and controlling interest in Peoples Loan & Investment Company (called PL&I), now being liquidated in a bankruptcy proceeding under Chapter X of the Bankruptcy Act in the United States District Court for the Western District of Arkansas. The shareholders of PL&I are scheduled to receive nothing.

If the individual investors in ITC have no standing to sue persons directly misrepresenting facts material to their securities purchase in interstate commerce under Rule 10 b-5, then it stands to reason that ITC may have no standing to sue the persons directly misrepresenting the assets of American Home Builders Supply Company, the holding company whose assets ITC was purchasing. The problem presented here is further compounded when one considers the possibility that instrumentalities of interstate commerce were used only in connection with the first step of the fraudulent action, i. e., the inducement of the South Dakota investors to provide by securities purchases the funds to effectuate the second step of purchasing the worthless assets.

Such a result runs contrary to the enunciated securities policy of Congress recognized by this Court.[2] The result is clearly contrary to the language of SEC Rule 10 b-5 prohibiting securities fraud in interstate commerce directly or **indirectly**. See **Carpenter v. Hall**, 311 F. Supp. 1099, 1106 (D. C. S. D. Tex. March 16, 1970).

---

[2] SEC v. Capital Gains Research Bureau, 375 U. S. 180, 80 S. Ct. 275, 11 L. Ed. 2d 237 (1963), and SEC v. National Securities, Inc., 393 U. S. 453, 89 S. Ct. 564, 21 L. Ed. 668 (1968).

Good conscience and the dictate of moral reason cry for the fashioning of a remedy to rectify the evil perpetrated here.

2. **Conflicting characterization of an SEC Rule 10 b-5 action—Subsequent relevant opinion of the Arkansas Supreme Court.**

The respondents cite **Skelly Oil Co. v. Phillips Petroleum Co.**, 339 U. S. 667, 674 (1950), for the proposition that this Court will not re-examine questions of local law as applied by the lower courts. That case was a declaratory judgment action to determine the continued effectiveness of a natural gas purchase and sale contract, and the holding of the Court was not pertinent to this federal cause of action.

Neither the District Court, nor the United States Court of Appeals below has applied the Arkansas law of fraud to the facts of this case, except where the United States Court of Appeals reversed the District Court and reinstated the common law fraud count as pendent to the federal question.

In support of the selection of the special two year limitations of action period created for violations of the civil liabilities section of the Arkansas Blue Sky Law, both Courts below have declared that Arkansas does not follow the legal or constructive fraud doctrine requiring no scienter, except in isolated cases not applicable here. Rather the Courts below say that Arkansas adheres to the ancient common law fraud doctrine of **Derry v. Peek**, requiring scienter, thereby distinguishing a 10 b-5 action requiring no scienter from common law fraud requiring scienter in Arkansas. That declaration of Arkansas law was made for the sole purpose of characterizing a 10 b-5 action in order to choose the most appropriate Arkansas

limitation of actions provision for the federal 10 b-5 action having no federal limitations of action provision itself.

Since the time of the decisions of both the District Court and the United States Court of Appeals below, the Supreme Court of Arkansas has decided a related case involving the very facts now before this Court in favor of an alleged third party tort feasor, the City National Bank of Fort Smith, Arkansas, on the basis of legal or constructive fraud. The Supreme Court of Arkansas held that the general statement made by the Bank officer was nothing more than an expression of an opinion and that such a statement cannot furnish the basis of a cause of action for legal or constructive fraud. But in so holding, the Supreme Court of the State of Arkansas clearly and unequivocally said on the very facts now before this Court:

> "appellant (Miskimins, one of the petitioners before the United States Supreme Court) hinges his argument for reversal upon the existence of a genuine issue of material fact as to his right to relief for legal or constructive fraud and for violation of SEC Rule 10 b-5. We shall first discuss the cause of action for legal or constructive fraud. We feel that no discussion of any possible cause of action for actual fraud is warranted. In the first place, we find no support for such a cause and, in the second place, appellant seems to have abandoned this basis for relief.
>
> "**we have clearly recognized long ago that there may be a cause of action for legal, or constructive fraud, even though there is a complete absence of any moral or evil intention.** Stewart v. Clark, 195 Ark. 943, 115 S. W. 2d 887." Miskimins v. The City National Bank of Fort Smith, Arkansas, 248 Ark. 1194, ... S. W. 2d ... (June 29, 1970). (Emphasis supplied.)

Thus, the Courts below are patently erroneous in their declarations as a matter of fact of the state of Arkansas fraud law. The erroneous declaration that Arkansas requires "scienter" for fraud is absolutely necessary to any reasonableness in the lower court's conclusion of dissimilarity in Arkansas between fraud and a 10 b-5 action. The **Miskimins v. The City National Bank of Fort Smith** case, supra, destroys the foundation of the rationale supporting the limitations choice of the Courts below.

Either the three year statute of limitations applicable to torts, actual fraud, constructive fraud and all actions based on implied liability, or the general five year statute applicable to actions not otherwise expressly limited should be applied here. See Ark. Stats., Section 37-213.

These seventeen South Dakota petitioners, together with Investors Thrift Corporation, invested their life savings in a venture admittedly represented to have net assets in excess of $600,000.00. In 1967, they learned that the liabilities exceeded the assets by $500,000.00, for a swing of $1,100,000.00. Had they lived in Fort Smith rather than Platte, South Dakota, perhaps they could have discovered the fraud sooner than they did. Perhaps they had through some technically legal agent sufficient notice to put them on inquiry of fraud earlier than they filed this action. Does the concept of justice prevailing in this country require these petitioners to institute an action at a time when the myriad accounting facts are not assimilated sufficiently to withstand motion for summary judgment in the name of a policy of repose for the wrong doers having no logical basis here?

Fundamental human rights existing in our society, rights which this Court has so zealously guarded in the past should not be abandoned here to satisfy some technical reason for refusing to rectify an obvious and sub-

stantial evil done by the respondents to these petitioners. Basic and fundamental concepts of simple fairness and justice dictate that the economic lifeline of these individual petitioners be not broken, nor their faith in the integrity of this substitute for other and more direct forms of trial be shattered.

Ample justification for acceptance of this petition for writ of certiorari exists here. A later exercise of supervision by this Court will not restore the shattered lives of these before the Court now, nor those unfairly injured in the interim.

The petitioners earnestly pray that this Court grant this writ.

Respectfully submitted

WILLIAM M. STOCKS

DONALD P. CALLOWAY
615 North B Street
P. O. Box 23
Fort Smith, Arkansas 72901
Counsel for Petitioners